Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Burton | Analyst: Norman Catelli | Bill Number: SB 640

Related Bills: See Prior Analysis | Telephone: 845-5117 | Amended Date: September 3, 2003

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: State Agency Contracts/Expatriate Corporations/California Taxpayer and Shareholder Act of 2003

X	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended July 10, 2003.
____	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended July 10, 2003.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ______________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED July 10, 2003. STILL APPLIES.
X	OTHER - See comments below.

SUMMARY

This bill would prohibit the state, absent a compelling public interest, from entering into contracts or agreements with certain publicly traded foreign (non-U.S.) corporations.

SUMMARY OF AMENDMENT

The September 3, 2003, amendments:

- Clarify that the provisions of the bill apply to contracts for goods and services, in addition to construction contracts, eliminating the technical consideration from previous analyses,
- Clarify that the provisions of the bill apply to a "state agency" and define that term,
- Require state agencies, as a condition of the contract, to receive a certificate from the vendor stating that the vendor is eligible to contract with the state pursuant to the provisions of this bill,
- Clarify that the Franchise Tax Board will consent to the termination of a water's-edge contract or election, if the purpose is to permit a state agency to contract with an expatriate corporation pursuant to the provisions of this bill, and
- Contain "double-jointing" language in the event that proposed changes to the water's-edge provisions contained in another bill are enacted before this bill is enacted.

POSITION

Pending.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	9/8/03
____ N	____ OUA	X PENDING		

LSB TEMPLATE (rev. 5-03)

Summary of Suggested Amendments

As noted in the analyses of this bill as amended June 19, 2003, May 7, 2003, and July 10, 2003, amendments are recommended to clarify various definitions used in this bill. Department staff is available to assist the author with amendments.

IMPLEMENTATION CONSIDERATIONS

The implementation considerations from prior analyses are provided below for convenience.

The concept of “substantial business activities” in the place of incorporation plays a significant role in this bill, but the statutory language does not define the concept. The bill lacks qualitative or quantitative standards by which the substantiality of business activity is to be evaluated for this purpose. Since this bill is evaluating foreign corporations, it may be advisable to consider how the United Kingdom and other European tax systems incorporate the concept of “substantial business activities.”

The term “substantially all” referring to the acquisition of a domestic corporation's properties requires a definition. The phrase is not specifically defined in the Internal Revenue Code reorganization provisions, although federal case law and administrative pronouncements have defined it in certain contexts. For example, a corporation’s interest expense deduction on debt incurred to acquire another corporation is limited. For this purpose, “substantially all” is defined as 90% of the fair market value of the net assets or 70% of the fair market value of the gross assets. Similarly, for purposes of certain corporate reorganizations or inclusion in a federal consolidated income tax return, “substantially all” is defined as 80% of stock value and voting power. Additionally, in certain corporate reorganizations there is a “continuity of interest” requirement to prevent transactions that resemble sales from benefiting from favorable treatment. For this purpose, 50% of the value of the new stock is to be received by the former owners to receive the favorable treatment.

The provision relating to the stock of the new parent held by a former shareholder or partner requires clarification. In an effort to avoid being classified as an “expatriate corporation” the former owners may receive securities other than common stock, thus keeping the 50% ownership threshold from being met. Some securities that may be used to avoid the expatriation threshold are convertible debt, tracking stock, and exchangeable stock.

Subparagraph (A) of paragraph 1 of subdivision (b) on page 5 of the bill contains the phrase “. . . the public trading of the foreign incorporated entity.” This phrase probably should be modified to refer to “. . . the public trading of stock of the foreign incorporated entity.”

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